

Can a stock market comeback be sustained?

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A comeback for stocks

We saw a strong comeback this past week for stocks globally. But what caused it, and can it be sustained?

Long-term optimism

I expect more volatility in the short term but am much more optimistic for a sustainable comeback in the long term.

Looking for opportunities

I believe it's time to look for opportunities and begin dollar-cost averaging in coming weeks and months as various stock markets form a bottom.

Everybody loves a good comeback story — but some are more impressive than others. One of the greatest comebacks was Winston Churchill. Few remember that, as a young man, he was First Lord of the Admiralty in Great Britain and was held responsible for the failure of the Gallipoli Campaign and other errors during World War I. He was widely criticized and forced to resign, but he decided to attempt a comeback. It took years to revive his reputation, but he ultimately became a beloved and respected prime minister who guided the UK — and the world — through World War II.

We've seen other great comebacks in history, like Ulysses S. Grant (from military retiree to debt-ridden businessman to Civil War general and president of the United States) and Lee Kuan Yew (who helped turn Singapore into an economically vibrant powerhouse after the disappointment of a short-lived merger with Malaysia). But there have been some rather weak comebacks too — French emperor Napoleon Bonaparte escaped exile in Elba and returned to France, but his second reign ended famously in about 100 days with a devastating loss at the hands of the British at Waterloo.

I mention these examples because we've seen a strong comeback this past week for stocks globally. The MSCI World Index rose 4.6% last week, led by the US but with European stocks also experiencing a strong rebound.¹ In particular, tech stocks posted strong gains, with the NASDAQ Composite Index rising more than 6%.² But this raises two questions: 1) What caused the rebound? 2) Can it be sustained?

What caused the rebound?

So let's tackle the first question. It's hard to divine exactly what caused the rally, but I believe it was a combination of factors. At the start of the week, we got news that the Biden administration is considering rolling back some of the Trump-era tariffs on Chinese goods.³ Tariffs were never a good thing for the US economy, in my view, and while they're not a major source of inflation, every little bit counts. So I believe this rightly improved investor sentiment.

Then there was the triad of major CEOs — JPMorgan Chase's Jamie Dimon, Citigroup's Jane Fraser, and Bank of America's Brian Moynihan — who said at the World Economic Forum in Davos that the US economy is in good shape, that the labor market is tight, and that the US will likely avoid a recession.⁴ I believe that certainly helped to support positive sentiment.

Then came the Federal Open Market Committee minutes, which most observers viewed as rather dovish. The Federal Reserve (Fed) recognized that their tough talk has done some of the heavy lifting for them, with financial conditions already having tightened meaningfully. The minutes show a Fed that is anticipating a "double-double play" — 50 basis point hikes at the next two meetings — and then an assessment of where the Fed would go next, which could lead to a

less aggressive tightening path from there. In other words, the Fed would be “data dependent” — which I believe is so critical to their being able to engineer a “soft landing.” Now, there are some more hawkish voices at the Fed — for example, Cleveland Fed President Loretta Mester said earlier this month that if inflation failed to “moderate” by September, then “a faster pace of rate increases may be necessary.”⁵ But that seems to be the minority view, at least for now.

We also heard from some US retailers who offered a more positive view of the US economy than some of their peers who reported previously. It turns out that some US retailers are continuing to see customers spending robustly, while other retailers are able to manage despite increasing pressures.

Then there were the signs that US inflation could be peaking or has already peaked. The Fed’s preferred measure of inflation, core personal consumption expenditures, rose 4.9% year over year for April, down from 5.2% the previous month.⁶ It’s still very high, but moving in the right direction.

But this was not a US-only rally. European stocks also posted an impressive gain for the week. In her blog, European Central Bank President Christine Lagarde indicated her plans to incrementally take rates out of negative territory by the end of September. Sentiment was also helped by Eurozone flash Purchasing Managers’ Indexes (PMI). They indicated a rather resilient European economy despite the pressures of the Russia-Ukraine war.

And the rally wasn’t confined to equities. In fact, global bonds have been rallying in recent days. Some of this move has been driven by the view that central bank rate hikes have largely been priced in already. In addition, yields in many fixed income sub-asset classes are looking far more attractive than they did just a few months ago.

One market that didn’t rally last week was Chinese equities, although performance in the past month has been strong.⁷ That may be an initial reaction to comments from China’s Vice Premier Li Keqiang. One statement in particular hung over Chinese stocks like a lead balloon: “Economic indicators such as employment, industrial production, power consumption and freight have fallen significantly. The difficulties in some aspects, and to a certain extent, are greater than those experienced in 2020 when the epidemic hit the country severely.”⁸ Investors seem to forget that China recovered very quickly economically in the initial stages of the pandemic, so I am not surprised that the Chinese economy would be more negatively impacted by this wave of COVID. While the last week brought disappointing returns for Chinese equities, they have been participating in a rebound in the past month.

Can the rebound be sustained?

So is this a Churchill comeback or a Bonaparte comeback for global equities? In other words, is this sustainable? I believe it’s more of the latter right now with continued volatility and ups and downs in coming weeks — maybe even another substantial move lower. After all, we have quantitative tightening starting this coming week from the Fed. And this isn’t the staid, relatively miniscule level of balance sheet reduction we saw during the last round of tightening. This is

turbo quantitative tightening — I'll call it "TQT" — and that could rattle markets in the shorter term. I think there is too much uncertainty for global stocks to have already hit bottom and start a sustainable recovery.

We also just got news that European leaders have reached an agreement on banning Russian oil purchases by the end of 2022. While this could be positive from a geopolitical perspective, it will no doubt have a negative impact on the European economy – and could lead Russia to retaliate by cutting off the sale of Russia's natural gas, which Europe is more dependent upon. That would not be good for global stock market sentiment.

In addition, we still have the potential for inflation to flare up in the near term given commodity price/supply shocks resulting from the Russia-Ukraine war as well as continued supply chain pressures in the short term as China continues to manage the current wave of COVID.

Having said that, I believe over the longer term, this stock comeback could be more Churchill-like. Once we form a market bottom over the course of the next several months (with some regions lagging others), I am optimistic that a strong rally might ensue for stocks globally, and I expect it to be sustainable.

That means it's time to begin taking advantage of opportunities, which I believe are abundant. I wrote about tech stocks last week. Another area where I see opportunity is Chinese stocks, where sentiment is very negative (as I mentioned above) and valuations are very attractive, in my view. In addition, I anticipate continued monetary policy accommodation and strong fiscal stimulus. As my colleague Paul Jackson recently wrote, "I always felt that the enthusiasm for Chinese equities was overdone at the end of 2020. Likewise, I suspect that investors are now being overly cautious, which I believe has created an interesting entry point for what I think will become an important part of global equity benchmarks over the coming decades."⁹ One near-term catalyst could be upcoming PMIs for China, which I anticipate may show a small rebound, reflecting some easing of lockdowns and monetary stimulus.

In short, I believe it's time to look for opportunities in equities (and, frankly, fixed income and alternatives) and begin dollar-cost averaging in coming weeks and months as various stock markets form a bottom.

Notes

¹Source: MSCI as of May 27, 2022. ²Source: Bloomberg, L.P., as of May 27, 2022. ³Source: CNBC, "Biden says White House could drop Trump China tariffs to slower consumer prices," May 10, 2022. ⁴Sources: Bloomberg News, "Dimon says 'storm clouds' over the US economy may dissipate," May 23, 2022; Fox Business, "Bank of America CEO: US consumer in 'very good shape,' makes Fed's job 'tougher,'" May 26, 2022; CNBC, "Citi CEO Jane Fraser is convinced Europe will fall into a recession," May 23, 2022. ⁵Source: Marketwatch, "Mester puts 75 basis point rate hike back on table for September," May 13, 2022. ⁶Source: US Bureau of Economic Analysis, May 27, 2022. ⁷Source: MSCI. The MSCI China Index was up 4.3% in the past month, but down 0.4% in the past week, as of May 27, 2022. Total return in local currency. The The MSCI China Index captures large- and mid-cap representation across China H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). An investment cannot be made directly in an index. ⁸Source: South China Morning Post, "China GDP: economic growth likely to 'fall far short', premier admits as crisis concerns mount," May 26, 2022. ⁹Source: Invesco, "Uncommon truths: Why I like Chinese equities," Paul Jackson, May 29, 2022.

Important information

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

All investing involves risk, including the risk of loss.

Many products and services offered in technology-related industries are subject to rapid obsolescence, which may lower the value of the issuers.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

The MSCI World Index is an unmanaged index considered representative of stocks of developed countries.

The NASDAQ Composite Index is the market capitalization-weighted index of approximately 3,000 common equities listed on the Nasdaq stock exchange.

The Federal Open Market Committee (FOMC) is a 12-member committee of the Federal Reserve Board that meets regularly to set monetary policy, including the interest rates that are charged to banks.

A basis point is one hundredth of a percentage point.

Personal consumption expenditures (PCE) measure price changes in consumer goods and services. Expenditures included in the index are actual US household expenditures. Core PCE excludes food and energy.

Purchasing Managers Indexes are based on monthly surveys of companies worldwide, and gauge business conditions within the manufacturing and services sectors.

Quantitative tightening (QT) is a monetary policy used by central banks to normalize balance sheets.

Dollar-cost averaging is an investment technique of buying a fixed dollar amount of a particular investment on a regular schedule, regardless of the share price. The investor purchases more shares when prices are low and fewer shares when prices are high.

The opinions referenced above are those of the author as of **May 31, 2022**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.